State of Florida

Public Service Commission

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-M-E-M-O-R-A-N-D-U-M-

DATE: March 1, 2007

TO: Director, Division of the Commission Clerk & Administrative Services (Bayó)

FROM: Division of Economic Regulation (Lester, Colson)
Office of the General Counsel (Bennett)

RE: Docket No. 060793-EI – Petition for approval of long-term fuel transportation contracts with Duke Energy Southeast Supply Header, LLC and CenterPoint Energy Southeastern Pipelines Holding, L.L.C. ("SESH Pipeline Contracts"), by Progress Energy Florida, Inc.

AGENDA: 03/13/07 – Regular Agenda – Proposed Agency Action - Interested Persons May Participate

COMMISSIONERS ASSIGNED: All Commissioners

PREHEARING OFFICER: Carter

CRITICAL DATES: None

SPECIAL INSTRUCTIONS: None

FILE NAME AND LOCATION: S:\PSC\ECR\WP\060793.RCM.DOC

Case Background

On December 12, 2006, Progress Energy Florida, Inc. (PEF) petitioned the Commission requesting Commission approval of the terms and conditions of its contracts with the Southeast Supply Header Pipeline (SESH). PEF also requests that the Commission determine that the costs associated with the pipeline contracts are recoverable through the fuel cost recovery clause subject to annual review by the Commission to ensure that the costs are being managed in a reasonable and prudent manner.

The SESH pipeline will begin at the Perryville hub in Northeast Louisiana and end with an interconnection with the Gulfstream Natural Gas System pipeline (Gulfstream) in Mobile County, Alabama. The SESH pipeline will interconnect with the Gulfstream and Florida Gas Transmission (FGT) pipelines, which are the two pipelines currently serving PEF and peninsular Florida. The SESH pipeline will connect the Florida market area with new gas production basins: Barnett Shale in East Texas and Bossier Sands in North Louisiana.

Below are pertinent facts regarding SESH:

FACTS ON THE SOUTHEAST SUPPLY HEADER PIPELINE	
Total Capacity	1 Million Dekatherms per day[1]
PEF's Share of Capacity	100,000 Dekatherms per day, thru May 2009 150,000 Dekatherms per day, thru May 2010 200,000 Dekatherms per day, thru May 2022 50.000 Dekatherms per day, thru May 2023
Estimated In-service Date	Mid-2008
Length	Approximately 270 miles
Diameter of Pipe	36-inch
Ownership	Joint Project between CenterPoint Energy Gas Transmission and Duke Energy Gas Transmission
[1] 1 Dekatherm = 1 MMBtu = 1,000,000 Btu The Precedent Agreement states pipeline capacity in dekatherms per day. Natural gas prices are typically stated as dollars per MMBtu.	

PEF requests that the Commission approve the costs associated with the SESH pipeline and the terms and conditions of the contracts on or before March 15, 2007.

There is no legal requirement that PEF request approval of the contracts or the costs in advance of the costs being incurred. Neverless, in the last fuel clause proceeding, Docket No. 060001-EI, the Commission approved costs associated with Florida Power & Light Company's participation in the SESH pipeline as appropriate for recovery through the fuel cost recovery clause beginning in 2008. (See Order No. PSC-06-1057-FOF-EI, issued December 22, 2006).

The Commission has jurisdiction pursuant to Sections 366.041 and 366.06, Florida Statutes.

Discussion of Issues

Issue 1: Should the Commission approve the terms and conditions of Progress Energy's long term fuel transportation contracts with Southeast Supply Header, LLC (an affiliate of Duke Energy Gas Transmission, LLC) and CenterPoint Energy Southeastern Pipelines Holding, LLC. (an affiliate of CenterPoint Energy, Inc)?

Recommendation: No. As a matter of policy, the Commission should not approve the terms and conditions of the long term fuel contracts between PEF and Southeast Supply Header, LLC (an affiliate of Duke Energy Gas Transmission, LLC) and CenterPoint Energy Southeastern Pipelines Holding, LLC. (an affiliate of CenterPoint Energy, Inc). PEF already has sufficient certainty concerning the regulatory treatment of these contracts.

Staff Analysis: PEF petitioned the Commission seeking approval of the terms and conditions of its long term fuel contracts with Duke Energy Southeast Supply Header, LLC (an affiliate of Duke Energy Gas Transmission, LLC) and CenterPoint Energy Southeastern Pipelines Holding, LLC. (an affiliate of CenterPoint Energy, Inc), hereinafter referred to as the SESH Pipeline Contracts or SESH Pipeline. The five contracts for which PEF seeks Commission approval are: (1) a Precedent Agreement between PEF and Southeast Supply Header, LLC; (2) an agreement for Negotiated Rates for Transportation Services Under SESH Rate Schedule FTS Contract No. 840006 between Southeast Supply Header, LLC and PEF; (3) an agreement for Negotiated Rates for Transportation Service Under SESH Rate Schedule FTS Contract No. 840007 between Southeast Supply Header, LLC and PEF; (4) a Service Agreement, Contract No. (1A) 840006, between Southeast Supply Header, LLC and PEF; and (5) a Service Agreement, Contract No. (1A) 840007, between Southeast Supply Header, LLC and PEF. PEF requested that the Commission rule on the prudence of entering into such contracts and to approve all terms and conditions of the contracts. PEF sought Commission approval on or before March 15, 2007, consistent with the terms and conditions of the contract.

The SESH contracts do not require prior Commission approval of the contracts' terms and conditions. Rather, the Precedent Agreement allows PEF to terminate its rights and obligations under the SESH contracts if the Commission does not approve recovery of costs associated with PEF's obligations under the SESH contracts through the fuel cost recovery clause. PEF has until March 15, 2007 to either obtain Commission approval of fuel clause cost recovery or waive that particular condition precedent. The parties may extend the period for Commission approval of fuel clause cost recovery up to ninety days.

The Commission has previously given its guidance to investor owned electric utilities with basic guidelines for procurement of long term fuel and transportation contracts in Order No. 12645, issued November 3, 1983, in Docket No. 830001-EI. The Commission set forth a broad policy on new long term fuel contracts which it set out in Appendix A to the Order No. 12645. A copy of the order and guidelines is attached to this recommendation. The Commission ruled that compliance with the guidelines was not a prerequisite to fuel clause recovery but rather that if the utility did not comply with the guidelines; it would have a special burden to show that non-compliance was justified. The guidelines did not require Commission approval of contracts but rather is a substitute for its approval. Having previously given its guidance, the Commission should not be called upon to review and approve the terms and conditions of any long term fuel or transportation contract a utility enters into. To do so is to invite the Commission to become involved in the management of the utility. Contract approval implies the Commission knew and was involved with all portions of contract negotiations. In essence, the Commission becomes a party to the contract rather than a regulator of the utility.

In support of its position that the Commission has previously reviewed and approved long term contracts, PEF cites Order No. PSC-05-0721-FOF-EI, issued July 5, 2005, in Docket No. 041414-EI, In re: Petition for approval of long-term fuel supply and transportation contracts for the Hines Unit 4 and additional system supply and transportation by Progress Energy Florida, Inc. In that docket PEF had filed a petition for approval of its long term fuel supply and transportation contracts for fuel requirements for its Hines Unit 4. The contracts were with BG LNG Services, LLC for re-gasified liquefied natural gas supply, not only for Hines Unit 4, but also for several other units on PEF's system. In addition, there was a contract for firm pipeline transportation from Southern Natural Gas Company (SONAT) through an expansion of SONAT's existing system to be built from Elba Island to an interconnection point with the Florida Gas Transmission (FGT) pipeline. There was also a third contract for firm pipeline transportation from an interconnection point with FGT to PEF's Hines Energy Complex.

Uncertainty concerning regulatory treatment for these long term contracts for Liquefied Natural Gas (LNG) was real, especially since PEF had a lower priced potential provider respond to its RFP. The Commission found that "it was reasonable for PEF to eliminate this [lower priced] option due to the significant uncertainty associated with the in-service date of the project," Order No.PSC-05-0721-FOF-EI, p. 5. The Commission found sufficient certainty with the LNG option, and also acknowledged that "the contracts offer important geographic advantages for PEF and its rate payers due to the increase in operational flexibility and supply diversity." Id. In addition, the Commission had concerns with the contract because it was based on a new fuel type and delivery mechanism, because the "new fuel type and delivery mechanism may expose PEF and its ratepayers to new risks that may not be fully mitigated in PEF's contract." Id., p. 6. The Commission required the utility to "respond, as market conditions and events warrant, proactively and prudently to minimize risk and the costs associated with these contracts which are borne by the ratepayers." Id., p. 7.

The Commission approved the contracts, but its review was limited to four specific areas at PEF's request: "(1) the market-based pricing index and the basis used for gas pricing in the re-gasified LNG supply contract; (2) the negotiated transportation rates from SONAT and FGT; (3) the volume of gas that PEF would accept under the re-gasified LNG supply contract; and (4) the duration of the contracts." Id. The Commission permitted recovery of the contract costs through the fuel and purchased power cost recovery clause "subject to a finding that PEF has managed the contracts in a reasonable and prudent manner." Id.

When Florida Power & Light Company submitted similar long term fuel transportation contracts for approval with the Commission, the Commission approved fuel clause recovery of the costs associated with the gas transportation project but did not address the terms and conditions of the contract itself.

There is no regulatory uncertainty associated with these SESH contracts. The Commission should decline to review or approve the terms and conditions of the SESH Pipeline Contracts as a matter of policy. The Commission has previously given its guidance to utilities on procurement of long term contracts. The utility should be able to follow those guidelines to meet its need without specific Commission approval of each term and condition of its contracts.

Issue 2: Are the costs associated with PEF's proposed participation in the Southeast Supply Header pipeline appropriate for recovery through the fuel cost-recovery clause beginning in 2008?

Recommendation: Yes, costs associated with PEF's proposed participation in the Southeast Supply Header Pipeline project are appropriate for recovery through the fuel cost recovery clause. The Commission should allow PEF to charge the gas transportation costs associated with the pipeline to the clause when the pipeline begins providing service to PEF. The costs associated with this pipeline, like all gas transportation costs, will be subject to the annual cost review in the fuel clause proceeding and further review, subject to a finding that PEF has managed its contracts in a reasonable and prudent manner. (Lester, Colson)

Staff Analysis: In its petition, its testimony, and its responses to staff's discovery, PEF represents that enhancing the diversity and reliability of its natural gas supply is the primary purpose for its participation in the SESH pipeline. In addition, the pipeline will allow PEF to access new gas supply to meet growing natural gas supply requirements. A secondary reason is that the new pipeline creates the potential for lower gas costs, i.e., fuel savings for customers.

Currently, PEF depends heavily on the Mobile Bay area to meet its gas supply needs. PEF projects that by 2009, without the addition of the SESH pipeline, approximately 78% of its gas transportation capacity on the Gulfstream and FGT pipelines will be sourced from the off-shore Mobile Bay area. This area is susceptible to production curtailments during and after Gulf of Mexico hurricanes and tropical storms. With the SESH pipeline, PEF's reliance on the Mobile Bay area will be reduced to approximately 39%.

PEF notes that its participation in the SESH pipeline will allow it access to on-shore gas sufficient to fuel approximately 1,500 megawatts (MW) of gas-fired capacity. PEF currently has 4,300 MW of gas-fired capacity.

By participating in the SESH pipeline, PEF projects that, by 2009, the new pipeline would support 200,000 MMBtu per day of PEF's total Mobile Bay firm transportation., which is approximately 400,000 MMBtu per day. Therefore, PEF's participation in the SESH pipeline would give it access to on-shore gas and cut in half its reliance on the Mobile Bay area for supply. PEF would ship the gas to its plants in Florida using its existing transportation capacity on the Gulfstream and FGT pipelines.

PEF states that its participation in the SESH pipeline will increase supplier diversity. The SESH pipeline will connect the Mobile Bay area with new gas production basins: Barnett Shale in East Texas and Bossier Sands in East Texas and North Louisiana. Production from these basins is growing and the production technology is proven. The pipeline will allow PEF access to independent producers in this area.

PEF notes that it has growing requirements for gas, that gas production in the Mobile Bay area will not be sufficient to meet the additional requirements, and that gas production in the Mobile Bay area is declining. PEF's demand for gas will grow by approximately 200,000 MMBtu per day over the next four years. PEF has over 4,300 megawatts of gas-fired generation capacity in Florida and projects adding more than 2000 megawatts by 2014. In general, Florida will need an additional 1,200,000 MMBTU per day of natural gas by 2010 to meet the requirements of gas-fired generation expansions.

By participating in the SESH pipeline, PEF will incur additional gas transportation costs. This cost will result from transporting gas on the pipeline and will be based on the rates – fixed demand charges and variable commodity charges – negotiated between PEF and the SESH pipeline. The Commission has granted confidential treatment of the negotiated rates. PEF states this transportation cost will be similar to the transportation costs it incurs with Gulfstream and FGT.

PEF notes that the additional gas transportation costs could be offset by lower gas costs. Currently, the Mobile Bay area gas prices carry a premium over NYMEX prices. That is, gas at the Mobile Bay Hub is typically more expensive than gas at Henry Hub. Since the SESH pipeline will increase gas supply in the Mobile Bay area, gas prices should decrease, which would reduce or eliminate the premium. The resulting savings could partially or entirely offset the additional gas transportation costs.

In evaluating whether to participate in the SESH pipeline, PEF considered several options. PEF considered an on-shore gas supply and transportation bundle. This option would enhance reliability of fuel supply but it would not increase the number of potential suppliers. Furthermore, the SESH pipeline was more cost effective. PEF considered additional storage, which would act as a physical hedge and provide a reliable source of gas during hurricanes and tropical storms. While PEF has contracted for firm storage, additional storage will not provide more gas to meet growing requirements.

PEF also considered purchasing additional liquefied natural gas (LNG). PEF has a LNG supply and transportation arrangement with BG LNG Services, LLC and the Cypress pipeline, which will bring LNG from Savannah, Georgia to an interconnection with FGT in Clay County, Florida. This arrangement will make up approximately 14% of PEF's gas supply portfolio. The Cypress pipeline will begin service in May 2007. PEF states that additional LNG would not increase supply diversity and that the Gulf of Mexico LNG terminals are susceptible to hurricanes and tropical storms.

Staff agrees with PEF that its participation in this new pipeline will increase the reliability of gas supply. The SESH pipeline will provide a significant amount of on-shore gas. Severe weather events are much less likely to interrupt the delivery of on-shore gas. Since the pipeline will interconnect with both Gulfstream and FGT, PEF's operational flexibility will be enhanced.

Staff believes diversifying by supply basin is important. Such diversification increases reliability of supply. Also, diversification increases the number of suppliers, which potentially could lead to fuel savings. Furthermore, having access to several supply basins protects against declining production, temporary or permanent, in a particular basin. PEF's participation in the SESH pipeline will provide new gas supply to meet growing demand.

PEF's participation in the new pipeline will result in additional gas transportation costs. This cost or some portion of it could be offset by lower gas costs in the Mobile Bay area. The premium in the Mobile Bay area likely will be greatest during Gulf of Mexico hurricanes and tropical storms. Staff emphasizes that, depending on the market factors, PEF may or may not realize actual savings.

Based on Order No. 14546, issued July 8, 1985 in Docket No. 850001-EI, the SESH pipeline costs are gas transportation costs and qualify for cost recovery through the fuel cost recovery clause. In the recent fuel clause proceeding, the Commission granted similar cost recovery to FPL for the same pipeline (See Order No. PSC-06-1057-FOF-EI issued December 22, 2006 in Docket No. 060001-EI). If PEF's participation in the SESH pipeline is approved, the Commission would have the opportunity to review these charges during the annual fuel clause proceeding.

Staff believes PEF has acted prudently in considering a number of gas supply options as part if its decision to participate in the SESH pipeline. Staff has reviewed the costs associated with the SESH pipeline and believes the costs are reasonable.

For the reasons cited above, staff recommends the Commission find that PEF's proposed participation in the Southeast Supply Header pipeline is appropriate for recovery through the fuel cost recovery clause. The Commission should allow PEF to charge the appropriate costs to the clause when the pipeline begins providing service to PEF.

Issue 3: Should this docket be closed?

Recommendation: Yes. The Commission should close this docket upon issuance of a consummating order unless a person whose interests are affected by the Commission's decision files a protest within 21 days of the issuance of the proposed agency action. (Bennett)

Staff Analysis: If no timely protest to the proposed agency action is filed within 21 days, the Commission should close this docket upon issuance of the consummating order.